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TAGS: [ECON](#) [EIND](#) [ENRG](#) [PREL](#) [RS](#)
SUBJECT: RUSSIAN ELECTRICITY SECTOR PRIVATIZATION BEGINS
WITH SUCESSFUL STOCK OFFERING

Classified By: Econ M/C Quanrud by reason 1.4 (b) and (d).

1. (C) Summary. Russian electricity monopoly, RAO UES, on October 31 sold 14.4 percent of daughter company WGK-5 for \$459 million, marking the first of the restructured power generating companies to be successfully privatized. Speculation that Gazprom would acquire the entire offering proved to be unfounded. No one strategic investor received more than one percent of WGK-5 in the public offering, according to UES CEO Anatoliy Chubays. UES tells us foreign bidders are welcomed for the 25 percent stake sale of WGK-5 to be held in 2007, but it is clear that Gazprom or Rusal would dearly like to get their hands on this strategic morsel. On other reform news, the spot market for wholesale electricity is expected to grow from 20 percent in 2006 to 40 percent by 2008. End summary.

WGK-5 PRIVATIZATION BEGINS

2. (U) The electricity monopoly, RAO UES, on October 31 raised \$459 million through a successful public offering for a 14.4 percent stake in Wholesale Generating Company 5 (WGK-5), the first of its 20 restructured power generating companies set to be privatized. This is the first stage of UES' three part privatization program that will spin off all

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of UES' thermal power generating capacity. The issuance reduces UES' stake in WGK-5 from 87.7 percent to 75 percent. According to business newspaper Vedomosti, Gazprombank, the Finnish energy concern Fortum, the EBRD, independent gas producer Novatek, Vnesheconombank, and Nomos-Bank took the largest stakes in the offering. Step two of WGK-5's privatization will occur in mid-2007 when UES sells a 25 plus one percent lot to a strategic investor. Finally, UES will divest itself of its remaining shares in the last stage when it proportionately distributes the shares among UES' minority shareholders.

3. (SBU) In an October 24 meeting with econboff, UES Deputy Head of Strategy Alexey Kachay said a competitive bidding system would be employed to choose a strategic investor in stage two of WGK-5's privatization and that foreign investors would be welcomed. Responding to emboff concerns that the proposed strategic sectors law on foreign investment could complicate foreign bids, he said the WGK is not considered a monopoly and, in any case, the sale would not reach the 50

percent limit stipulated in the law.

¶4. (C) The government earlier this year approved additional public offerings for WGK-3 and WGK-4 in 2007. (Comment: The power shortages last winter and the blackout in Moscow last May probably helped persuade the Kremlin to speed up investment into the power sector's aging infrastructure. End comment.) UES plans to raise more than \$12 billion in 2007-08 by issuing shares for all of its restructured companies, according to the press.

GAZPROM'S POWER GRAB

¶5. (U) According to the press, the demand for the issuance was eight times greater than the amount offered, resulting in a price at the high end of nine cents per share. Speculation in recent days centered on Gazprom's interest in acquiring the whole 14.5 percent. One article this week surmised that the Gazprom news was a ploy to drum up interest in the offering. After the tender, UES CEO Anatoliy Chubays responded to concerns over Gazprom's acquisitions by reassuring the public that no one strategic investor would receive more than one percent of WGK-5 in this public offering.

¶6. (U) In addition, on October 27, RAO UES' board of directors approved Gazprom's acquisition of Mosenergo's additional share issuance for \$2.1 billion, which would increase the gas monopoly's stake in the Moscow utility to a controlling 52.4 percent.

GROWING SPOT MARKET

¶7. (U) According to UES, all major generation companies on January 1, 2006 became participants of the federal wholesale market. The unregulated wholesale electricity market will

increase gradually as regulated one to three-year contracts expire and wholesale customers start turning to the spot market. In addition, all future power generating capacity coming on-line will only sell to the spot market. In 2006, so far, 20 percent of the electricity consumed was traded (including retrades) at competitive spot market prices. UES plans to increase this share to 40 percent by 2008. The Federal Tariff Service continues to regulate prices for retail consumers and is set to increase prices by at least 10 percent in 2007.

¶8. (C) Comment: WGK-5's successful public offering should inject much needed investment into its power plants (Note: WGK-5 operates heating and power plants in the Moscow, Yekat and Rostov regions). The success will also encourage UES in its plans to issue additional shares for its other WGKs and RGKs (the Regional Generating Companies) in the 2007-08 period. UES's ability to keep Gazprom at bay in its power plant buying spree was a positive development, but the next stage of privatization in mid-2007 will be more decisive when UES sells a 25 percent stake in WGK-5 to a single strategic

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investor. Russia's industrialists, like Gazprom and RUSAL, are positioning themselves to acquire controlling stakes in these strategic assets. It remains to be seen if UES assurances to keep the process transparent and competitive can keep the potential mix of political and commercial interests at bay in determining the final ownership of these power generating companies. End comment.

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